

**May 3, 2011**

**Blaine F. Bates**  
Clerk

NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE TENTH CIRCUIT**

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IN RE KYLE STEVEN HEBERT,  
Debtor.

BAP No. WY-10-080

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KYLE STEVEN HEBERT,  
Appellant,

Bankr. No. 10-20120  
Chapter 7

v.

OPINION\*

RANDY L. ROYAL, Trustee,  
Appellee.

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Appeal from the United States Bankruptcy Court  
for the District of Wyoming

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Before CORNISH, Chief Judge, ROMERO, and SOMERS, Bankruptcy Judges.<sup>1</sup>

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CORNISH, Chief Judge.

Debtor appeals the bankruptcy court's order granting the trustee's objection to debtor's claimed exemptions in his 2009 federal tax refund attributable to withholdings of tax from unemployment compensation and a distribution of retirement funds. Having reviewed the record and applicable law, we affirm the

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\* This unpublished opinion may be cited for its persuasive value, but is not precedential, except under the doctrines of law of the case, claim preclusion, and issue preclusion. 10th Cir. BAP L.R. 8018-6.

<sup>1</sup> The parties did not request oral argument, and after examining the briefs and appellate record, the Court has determined unanimously that oral argument would not materially assist in the determination of this appeal. Fed. R. Bankr. P. 8012. The case is therefore ordered submitted without oral argument.

bankruptcy court's order for reasons other than those stated by the trial court.<sup>2</sup>

## I. BACKGROUND FACTS

Debtor Kyle Steven Hebert ("Debtor") filed a petition for Chapter 7 relief on October 26, 2009. After filing his 2009 federal income tax return, Debtor was entitled to a refund in the amount of \$1,044.<sup>3</sup> The refund was created by taxes withheld from several sources of income— wages, unemployment compensation, and a retirement plan distribution— together with a Making Work Pay credit.<sup>4</sup> At the request of the Chapter 7 trustee, Randy L. Royal ("Trustee"), Debtor turned over his entire tax refund.

Subsequently, Debtor amended his Schedule C to claim an exemption of that portion of his 2009 federal tax refund attributable to taxes withheld from his unemployment compensation.<sup>5</sup> He also claimed as exempt that portion of the refund attributable to taxes withheld from a distribution from his employer's 401(k) plan.<sup>6</sup> Trustee then objected to Debtor's claimed exemptions, arguing the taxes withheld did not retain their character as exempt pursuant to 11 U.S.C. § 522(b).<sup>7</sup> The parties stipulated to the facts and admission of Debtor's 2009

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<sup>2</sup> Our analysis differs somewhat from that of the bankruptcy court. However, an appellate court is "free to affirm . . . on any grounds for which there is a record sufficient to permit conclusions of law, even grounds not relied upon" by the trial court. *Griess v. Colo.*, 841 F.2d 1042, 1047 (10th Cir. 1988) (internal quotation marks omitted).

<sup>3</sup> *2009 Form 1040 at l. 72, in Appellant's App. at 75.*

<sup>4</sup> *See id. at ll. 61 & 63 and Forms W-2, 1099-R & 1099-G, in Appellant's App. at 75, 85, 86, 88.*

<sup>5</sup> *Amended Schedule C, in Appellant's App. at 60* (Debtor claimed as exempt "Unemployment Compensation & the proceeds thereto (including tax refunds derived therefrom)" pursuant to Wyoming Statutes § 27-3-319).

<sup>6</sup> *Second Amended Schedule C, in Appellant's App. at 66* (Debtor claimed as exempt "Income tax refund derived from 401(k) Distribution" pursuant to 26 U.S.C. § 401).

<sup>7</sup> *Trustee's Objections to Claim of Exemption, in Appellant's App. at 65 and*

federal income tax return.<sup>8</sup> A telephonic hearing was held on the matter after which the bankruptcy court entered an order granting Trustee’s objection to Debtor’s claimed exemptions.<sup>9</sup> That order caused this timely appeal.

## **II. APPELLATE JURISDICTION**

This Court has jurisdiction to hear timely filed appeals from “final judgments, orders, and decrees” of bankruptcy courts within the Tenth Circuit, unless one of the parties elects to have the district court hear the appeal.<sup>10</sup> Neither party elected to have this appeal heard by the United States District Court for the District of Wyoming. The parties have therefore consented to appellate review by this Court.

A decision is considered final “if it ‘ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.’”<sup>11</sup> A bankruptcy court’s order disallowing a debtor’s claimed exemption is final for purposes of appellate review.<sup>12</sup>

## **III. STANDARD OF REVIEW**

The facts of this case are undisputed. Debtor appeals the bankruptcy court’s interpretation of Wyoming exemption statutes. Thus, this appeal presents only legal issues, i.e., those of statutory construction, for determination. Legal

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<sup>7</sup> (...continued)  
71.

<sup>8</sup> *Joint Stipulation of Facts, in Appellant’s App.* at 72.

<sup>9</sup> *Order Sustaining the Trustee’s Objections to Debtor’s Claimed Exemptions, in Appellant’s App.* at 108.

<sup>10</sup> 28 U.S.C. § 158(a)(1), (b)(1), and (c)(1); Fed. R. Bankr. P. 8002; 10th Cir. BAP L.R. 8001-3.

<sup>11</sup> *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 712 (1996) (quoting *Catlin v. United States*, 324 U.S. 229, 233 (1945)).

<sup>12</sup> *In re Smith*, 401 B.R. 487, 488 (10th Cir. BAP 2009).

questions are reviewed *de novo*.<sup>13</sup> *De novo* review requires an independent determination of the issues, giving no special weight to the bankruptcy court's decision.<sup>14</sup>

#### IV. ANALYSIS

Wyoming is an "opt out state," and thus Wyoming statutory law, and not the federal exemption scheme provided in 11 U.S.C. § 522(d), is applicable. The parties do not dispute that under Wyoming statutes both unemployment compensation and benefits paid from an employer's retirement plan are exempt.<sup>15</sup>

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<sup>13</sup> *Pierce v. Underwood*, 487 U.S. 552, 558 (1988).

<sup>14</sup> *Salve Regina Coll. v. Russell*, 499 U.S. 225, 238 (1991).

<sup>15</sup> Unemployment compensation is exempt pursuant to Wyoming Statutes § 27-3-319, which provides in relevant part as follows:

§ 27-3-319. Waiver agreements void; exception; assignments void; exemption from levy

. . .

(c) Benefit rights are exempt from levy, execution, attachment or other debt collection remedy. Benefits received by an individual under this act and not combined with other funds of the recipient are exempt from debt collection remedies except those incurred for necessities furnished to the individual, his spouse or dependents during his unemployment. A waiver of exemptions provided by this subsection is void.

Wyo. Stat. Ann. § 27-3-319(c) (1997). The bankruptcy court determined the taxes withheld from Debtor's unemployment compensation were not exempt because they were combined with other types of funds, and therefore did not meet the requirement of the statute. In light of our analysis which follows, we need not address this issue.

Retirement benefits are exempt pursuant to Wyoming Statutes § 1-20-110, which provides in relevant part as follows:

§ 1-20-110. Exemption for retirement funds and accounts

(a) The following are exempt from execution, attachment, garnishment or any other process issued by any court:

(i) Any person's interest in a retirement plan, pension or annuity, whether by way of a gratuity or otherwise, granted, paid or payable:

(continued...)

What is disputed in this appeal, however, is whether taxes withheld from those types of exempt income and then ultimately refunded to the Debtor are exempt. Based on the Wyoming statutory exemption language, as well as *In re Annis*,<sup>16</sup> a decision of the United States Court of Appeals for the Tenth Circuit (“Tenth Circuit”), we agree with the bankruptcy court that they are not exempt.

On appeal, Debtor argues that funds withheld as taxes from exempt sources of income retain their exempt character when refunded to a debtor as overpayments by the Internal Revenue Service. To support this argument, Debtor

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<sup>15</sup> (...continued)

(A) By any private corporation or employer to an employee or a retired employee under a plan or contract which provides that the pension or annuity shall not be assignable; or

(B) To any city, town or county employee or retired employee who is not covered by the state retirement system, under a plan or contract which provides that the pension or annuity shall not be assignable.

(ii) Any retirement or annuity fund of any person, to the extent of payments made to the fund while solvent, but not exceeding the amount actually excluded or deducted as retirement funding for federal income tax purposes, and the appreciation thereon, the income therefrom and the benefits or annuity payable thereunder;

(iii) Any retirement or annuity fund of any person, to the extent payments are made to the fund while solvent, provided the earnings on the fund are protected from federal income tax or subject to deferral of federal income tax, or are not subject to federal income tax upon withdrawal, and the appreciation thereon, the income therefrom and the benefits or annuity payable thereunder . . .[.]

Wyo. Stat. Ann. § 1-20-110 (1998). The bankruptcy court determined the taxes withheld from Debtor’s retirement distribution were not exempt because they did not meet the requirements of § 1-20-110(a)(ii) above. Because the distribution was from Debtor’s account in his employer’s 401(k) plan, we believe §1-20-110(a)(i) is the applicable provision, but our analysis below is the same regardless of which type of retirement income the taxes are withheld from and then ultimately refunded to the debtor.

<sup>16</sup> *Manchester v. Annis (In re Annis)*, 232 F.3d 749 (10th Cir. 2000).

cites *In re Smith*,<sup>17</sup> a decision of this Court applying Utah law, *In re Sparks*,<sup>18</sup> a bankruptcy court case applying Ohio law, and the general proposition that “exemption statutes are to be liberally construed so as to effect their beneficent purposes.”<sup>19</sup> While we certainly agree that exemption statutes are to be construed liberally, the cases Debtor points to are distinguishable because the state exemption laws of Utah and Ohio differ from those of Wyoming.

In *Smith*, a debtor claimed an exemption for a refund resulting from an overpayment of taxes withheld from exempt retirement income.<sup>20</sup> The trustee objected and the bankruptcy court sustained the objection and disallowed the exemption.<sup>21</sup> When debtor appealed to this Court, we certified the following question to the Utah Supreme Court:

Whether pursuant to Utah code section [78B-5-507 (2008)] monies refunded to a taxpayer as an overpayment of taxes are exempt when the monies with which the tax deposit was made were exempt?<sup>22</sup>

Section 78B-5-505 of the Utah Code exempts retirement income:

(1)(a) An individual is entitled to exemption of the following property:

(*xiv*) except as provided in Subsection (1)(b), any money or other assets held for or payable to the individual as a participant or beneficiary from or an interest of the individual as a participant or beneficiary in a retirement plan or arrangement that is described in Section 401(a), 401(h), 401(k), 403(a), 403(b), 408, 408A, 409, 414(d),

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<sup>17</sup> 401 B.R. 487 (10th Cir. BAP 2009).

<sup>18</sup> 410 B.R. 602 (Bankr. S.D. Ohio 2009).

<sup>19</sup> Appellant’s Brief at 8 (citing *In re Lindell-Heasler*, 154 B.R. 748, 751 (D. Wyo. 1992)).

<sup>20</sup> *In re Smith*, 201 P.3d 1001, 1002 (Utah 2009).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* (footnote omitted).

or 414(e), Internal Revenue Code . . . [.]<sup>23</sup>

Further the Utah Code contains specific tracing language that is applicable to the retirement income exemption:

(2) Money or other property exempt under Subsection 78B-5-505(1)(a)(iii), (iv), (v), (vi), (vii), (xiii), or (xiv) remains exempt after its receipt by, and while it is in the possession of, the individual or in any other form into which it is traceable.<sup>24</sup>

Applying these statutes, the Utah Supreme Court held “that in the case of exempt retirement income, refunds from the overpayment of taxes remain exempt because the recordation of taxes and refunds is a reasonable method of tracing.”<sup>25</sup> Based on the Utah Supreme Court’s ruling on the certified question, this Court reversed the Utah bankruptcy court’s decision and held the debtor’s tax refund attributable to withholdings from retirement income was exempt.<sup>26</sup>

In *Sparks*, an Ohio bankruptcy court addressed the issue of “[w]hether an income tax refund directly traceable to” Ohio Public Employee Retirement System benefits, Ohio unemployment compensation benefits, and social security benefits was exempt.<sup>27</sup> As in the appeal before us, the debtor in *Sparks* argued that funds withheld as taxes from exempt sources of income retained their exempt character.<sup>28</sup> The *Sparks* trustee argued that “once otherwise exempt funds are withheld and paid to the government, the funds are transformed and may only be

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<sup>23</sup> Utah Code Ann. § 78B-5-505(xiv) (2008) (emphasis added).

<sup>24</sup> Utah Code Ann. § 75B-5-507(2) (emphasis added).

<sup>25</sup> *Smith*, 201 P.3d at 1002.

<sup>26</sup> *In re Smith*, 401 B.R. 487, 490 (10th Cir. BAP 2009).

<sup>27</sup> *In re Sparks*, 410 B.R. 602, 603 (Bankr. S.D. Ohio 2009).

<sup>28</sup> The debtor claimed the refunds were exempt pursuant to Ohio Rev. Code § 2329.66(A)(10)(a) (Ohio Public Employee Retirement System benefits); Ohio Rev. Code § 2329.66(A)(9)(c) (Ohio unemployment compensation benefits); and Ohio Rev. Code § 2329.66(A)(17) (social security benefits and § 401(k) benefits). *Sparks*, 410 B.R. at 604.

exempted under statutory sections specifically applicable to tax refunds.”<sup>29</sup> Relying on *In re Cook*,<sup>30</sup> another Ohio bankruptcy court case, the *Sparks* bankruptcy court ruled that the tax refund was exempt.<sup>31</sup>

The bankruptcy court’s decision in *Sparks* was premised on two critically related points. First, the court recognized that the legislative purpose and policy underlying the Ohio exemption statutes at issue is “to protect funds intended primarily for maintenance and support of the debtor’s family.”<sup>32</sup> Second, and more importantly, the *Sparks* bankruptcy court was able to rely on the Ohio Supreme Court’s express sanctioning of the concept of tracing exempt funds in circumstances where those funds are intended for the support and maintenance of individuals.<sup>33</sup>

In *Daugherty v. Central Trust Co.*,<sup>34</sup> the Ohio Supreme Court ruled that exempt funds do not lose exempt status when deposited in a personal checking account if the source of the funds is known or reasonably traceable.<sup>35</sup> The *Sparks* bankruptcy court reasoned that “[i]n this context, there is no discernable critical distinction between exempt funds held in a bank or investment account and funds retained in the U.S. Treasury and returned as a tax refund as long as those funds

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<sup>29</sup> *Sparks*, 410 B.R. at 604.

<sup>30</sup> 406 B.R. 770 (Bankr. S.D. Ohio 2009) (a case decided only a few months earlier by another judge in the same district).

<sup>31</sup> *Sparks*, 410 B.R. at 607.

<sup>32</sup> *Id.* at 606 (citing *In re Cook*, 406 B.R. at 776).

<sup>33</sup> *Sparks*, 410 B.R. at 606.

<sup>34</sup> *Daugherty v. Cent. Trust Co. of Northeastern Ohio, N.A.*, 504 N.E.2d 1100 (Ohio 1986).

<sup>35</sup> *Id.* at 1103.

are reasonably traceable.”<sup>36</sup> As a result, the bankruptcy court denied the trustee’s objection, ruling that “allowing the claimed exemptions and thereby maintaining the original character of the funds as retirement and employee benefits is entirely consistent with the legislative purpose to promote the maintenance and support of individuals.”<sup>37</sup>

Unfortunately for Debtor, Wyoming’s Supreme Court has not recognized the tracing concept in case law as the Ohio Supreme Court has done. Nor do Wyoming’s exemption statutes contain “tracing language” like the Utah statutes. Accordingly, we believe the result in this case is dictated by the Tenth Circuit’s analysis in the *Annis* decision.<sup>38</sup>

In *Annis*, the debtor sought to exempt her federal and state income tax refunds resulting from wage withholdings pursuant to the Oklahoma statute exempting earnings from personal services.<sup>39</sup> The debtor argued that “at no time was the returned money itself a tax (. . . the withholding exceeded tax liability). The money instead at all times remained the employee’s wages, albeit wages held by the government for the employee.”<sup>40</sup> The bankruptcy court agreed and ruled the tax refunds were exempt. The trustee appealed to this Court, arguing the refunds did not satisfy the requirement of the statute. This Court reversed, and the debtor appealed to the Tenth Circuit.

On appeal to the Tenth Circuit, the debtor again argued that the withholdings from wages retained their exempt character when withheld and then refunded to the debtor by the Internal Revenue Service. The Tenth Circuit

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<sup>36</sup> *Sparks*, 410 B.R. at 607.

<sup>37</sup> *Id.*

<sup>38</sup> *Manchester v. Annis (In re Annis)*, 232 F.3d 749 (10th Cir. 2000).

<sup>39</sup> *Id.* at 750 (the statute construed is Okla. Stat. Ann. tit. 31, § 1.1 (1995)).

<sup>40</sup> *Id.* at 752.

responded that

The logical appeal of the argument, however, rests on the assumption that the withholding is not itself a “tax” and, therefore, the money never changed its form and remained, at all times, wages of the employee. That assumption is inconsistent with the wording of the Internal Revenue Code . . . [.] Specifically, the Internal Revenue Code deems the money withheld from an employee’s wages to constitute a “tax”: “Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages *a tax* determined in accordance with tables or computational procedures prescribed by the Secretary.” 26 U.S.C. § 3402(a)(1) (emphasis added). The withholding “tax” is then credited against any “tax liability” imposed under the Code: “The amount *withheld as tax* under chapter 24 shall be allowed to the recipient of the income as a credit against the tax imposed by this subtitle.” 26 U.S.C. § 31 (emphasis added). If the withholding “tax” exceeds “tax liability” under the Code, then the Commissioner refunds the difference. *See* 26 U.S.C. § 6402.<sup>41</sup>

Further, the Tenth Circuit explained:

As is apparent, then, the initial withholding itself constitutes a “tax,” with the refund constituting the return of an assessed tax. In the circumstances, the Debtor and the bankruptcy court were wrong to assert that the money never changed form but, instead, at all times remained wages of the employee (albeit, wages held for the employee by the government). Instead, once the wages were withheld as a “tax,” they lost their character as “wages.”<sup>42</sup>

Accordingly, based on Internal Revenue Code language that deems withholding to be a “tax,” the Tenth Circuit affirmed this Court’s decision that the tax refund was not exempt.<sup>43</sup>

Since it involved a claimed exemption of a refund generated by taxes withheld from wages under Oklahoma law, *Annis* may not at first blush appear

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<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 753. Prior to the *Annis* decision, the United States Court of Appeals for the Eighth Circuit, construing an exemption claimed under a Missouri garnishment statute, reached a similar conclusion in *In re Wallerstedt*, 930 F.2d 630 (8th Cir. 1991) (“We . . . hold that the Wallerstedts’ tax refunds are no longer earnings and are not exempt from the bankruptcy estate under Missouri law.”). *See also In re Benn*, 491 F.3d 811, 816 (8th Cir. 2007) (“Section 513.427 does not create an exemption for tax refunds, and no other Missouri statute or non-bankruptcy federal exemption statute permits a debtor to exempt tax refunds from the bankruptcy estate.”).

controlling here. However, the Tenth Circuit’s analysis is equally applicable to the facts and law of this case because the taxes withheld from Debtor’s unemployment compensation and retirement distribution are governed by the same Internal Revenue Code language.

The taxes withheld from Debtor’s unemployment compensation were done so pursuant to 26 U.S.C. § 3402(p)(2). That section provides as follows:

(p) Voluntary withholding agreements.--

(2) Voluntary withholding on unemployment benefits.--If, at the time a payment of unemployment compensation (as defined in section 85(b)) is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, ***such payment shall be treated as if it were a payment of wages by an employer to an employee.*** The amount to be deducted and withheld under this chapter from any payment to which any request under this paragraph applies shall be an amount equal to 10 percent of such payment.<sup>44</sup>

Thus, this statutory language implicates the language in 26 U.S.C. § 3402(a)(1) relied upon by the Tenth Circuit in *Annis* to deem the funds withheld to be a “tax,” i.e., “[e]xcept as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages ***a tax*** determined in accordance with tables or computational procedures prescribed by the Secretary.”<sup>45</sup>

Similarly, the taxes withheld from Debtor’s retirement income distribution were done so pursuant to 26 U.S.C. § 3405(c). That section provides as follows:

§ 3405. Special rules for pensions, annuities, and certain other deferred income

(c) Eligible rollover distributions.--

(1) In general.--In the case of any designated

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<sup>44</sup> 26 U.S.C. § 3402(p)(2) (emphasis added).

<sup>45</sup> *Annis*, 232 F.3d at 752 (citing 26 U.S.C. § 3402(a)(1)) (emphasis added).

distribution which is an eligible rollover distribution--

(A) subsections (a) and (b) shall not apply,  
and

(B) the payor of such distribution shall  
withhold from such distribution an amount  
equal to 20 percent of such distribution.

(2) Exception.--Paragraph (1)(B) shall not apply to any  
distribution if the distributee elects under section  
401(a)(31)(A) to have such distribution paid directly to  
an eligible retirement plan.

(3) Eligible rollover distribution.--For purposes of this  
subsection, the term “eligible rollover distribution” has  
the meaning given such term by section 402(f)(2)(A).<sup>46</sup>

Further, 26 U.S.C. 3405(f) provides

(f) Withholding to be treated as wage withholding under section 3402  
for other purposes.--For purposes of this chapter (and so much of  
subtitle F as relates to this chapter)--

(1) any designated distribution (whether or not an  
election under this section applies to such distribution)  
***shall be treated as if it were wages paid by an employer  
to an employee with respect to which there has been  
withholding under section 3402,*** and

(2) in the case of any designated distribution not subject  
to withholding under this section by reason of an  
election under this section, the amount withheld shall be  
treated as zero.<sup>47</sup>

Again, the language in 26 U.S.C. § 3402(a)(1) relied upon by the Tenth Circuit in  
*Annis* to deem the funds withheld to be a “tax” is equally applicable here.

Absent any language in the Wyoming exemption statutes or in Wyoming  
case law to establish the exempt character of Debtor’s tax refund if it can be  
reasonably traced to exempt sources, we see no way to distinguish the Tenth  
Circuit’s reasoning in *Annis*. Accordingly, we are compelled to affirm the

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<sup>46</sup> 26 U.S.C. § 3405(c).

<sup>47</sup> 26 U.S.C. § 3405(f) (emphasis added).

bankruptcy court's order denying the Debtor's claimed exemptions.<sup>48</sup>

## V. CONCLUSION

The bankruptcy court's order granting Trustee's objection to Debtor's claimed exemptions in his federal tax refund is AFFIRMED.

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<sup>48</sup> As pointed out by Judge Henry in his *Annis* concurrence, the argument that funds withheld as taxes from exempt sources of income retain their character when refunded to the debtor is not illogical, but we are constrained to leave the definition of exemptions in opt-out states to state lawmakers. *See Annis*, 232 F.3d at 753-54.